

our prospective customer since audit firms have a strong knowledge of the company's business issues.

(Div. Ex. 169 at 032054.) In November 1996, Zeev Gur, who headed PeopleSoft's consulting relationship with EY, wrote that PeopleSoft's alliance with EY grew significantly during the past year "both in the number of [PeopleSoft] trained consultants and the number of joint deals closed." (Div. Ex. 413 at 036203.)

EY publicized its close relationship with PeopleSoft in order to promote sales. An EY document titled "1998 Global Business Case for Our PeopleSoft Solution Team" bears the PeopleSoft Global Alliance Partner logo. (Div. Ex. 420.) The document describes the EY/PeopleSoft relations in terms of EY's status as auditor, PeopleSoft Global Solutions Provider, client, and expatriate relationship – EY/GEMS. (Div. Ex. 420 at 036336.)

In 1998, EY significantly strengthened its relationships with PeopleSoft's sales representatives in the field by sharing information about business leads and prospects. (April 1, 2003, Tr. 204-05; Div. Ex. 486 at 038541.) In 1998, EY did about half the PeopleSoft health-care implementations where the licensee used a third-party consultant or implementer. (March 31, 2003, Tr. 198.) Strong sales force relationships between EY and PeopleSoft continued as an EY objective in 1999. (Div. Ex. 199 at 032373.)

On December 1, 1998, at Mr. Fridley's direction, Ms. Duginski contacted two EY partners to support PeopleSoft's request that they urge a third EY partner to stop the purchase of a PeopleSoft competitor's software. (April 7, 2003, Tr. 17-19; Div. Ex. 293.)

During a meeting of twenty-five members of EY's PeopleSoft Service Line in December 1998, the attendees considered strategies for "Leveraging EY's audit relationship with PeopleSoft." (April 1, 2003, Tr. 191; Div. Ex. 363 at 035450.) The following comments were made in a wide-ranging discussion of options:

- (1) At times, EY's auditor status precluded it from partnering with PeopleSoft;
- (2) EY should leverage its audit relationship with PeopleSoft and use it to EY's advantage; and
- (3) EY should operate as one with PeopleSoft in terms of global focus and market opportunities.

(April 1, 2003, Tr. 184-86; Div. Ex. 363 at 035392, 035427.) The meeting participants theorized that if EY should become the dominant software implementer in three years, it would be because, among other things, EY:

- (1) "Engineered & delivered (with PeopleSoft)" with solutions in a variety of business areas.
- (2) "Targeted industries & markets through focused account planning & relationship building with senior [PeopleSoft] executives."
- (3) "Audit leverage, integrated services to help [PeopleSoft]."
- (4) Aligned with PeopleSoft on global growth.

- (5) Did not accept incorrect assumption that the audit relationship would cause EY not to achieve market dominance.

(Div. Ex. 363 at 035428.) These EY partners noted with respect to health care:

We know where PeopleSoft is looking to sell work and where PeopleSoft will need to be upgraded. This is all a matter of partnering with the 11 sales representatives from PeopleSoft and to work the current account list. That way, when they go to the account, they have our credentials and solution sets and everything. In addition, we will help PeopleSoft sell their product – if we do our job right.

(Div. Ex. 363 at 035480.) At the conclusion of the meeting, Mr. Fridley advised:

Obviously, the business plan is a working document that will continue to be refined to reflect our increased understanding of how the reorganized [Consulting] practice will work and the additional opportunities to partner with our clients and work more closely than ever with PeopleSoft.

(Div. Ex. 363 at 035499.)

The goal for EY's PeopleSoft Southeast Business Strategy in 1999, a major initiative of EY's PeopleSoft Service Line in Atlanta, was "Taking It to the Limit" and supporting PeopleSoft nationally. (April 2, 2003, Tr. 230; Div. Ex. 417.) EY and PeopleSoft personnel were matched/paired for communication and helped with sales/marketing initiatives. (Div. Ex. 417 at 036231.) Ms. Anderson testified that matching EY and PeopleSoft contacts was to provide EY with the name of the right person for information, but reluctantly admitted that the matching had a sales aspect. (April 2, 2003, Tr. 231-32.)

EY paid PeopleSoft \$5,000 to sponsor a PeopleSoft Worldwide Sales meeting held on February 21-23, 1999, where EY, as one of PeopleSoft's top twelve "partners," had an opportunity to meet 1,000 PeopleSoft salespeople. (April 2, 2003, Tr. 63-64; Div. Exs. 267 at 033791, 491.) In addition, EY sponsored two PeopleSoft events annually and spoke at local PeopleSoft events, conferences, and meetings. (Div. Ex. 417 at 036231.) From 1998 to 2000, EY sponsored and/or paid for golf outings at PeopleSoft health care conferences. (Div. Ex. 267 at 033780-82, 033790, 033792-93.)

On July 13, 1999, Mr. Fridley asked PeopleSoft to endorse EY to Standard Register, a PeopleSoft customer, in connection with EY's sales efforts.<sup>32</sup> (April 2, 2003, Tr. 56, 62; Div. Ex. 181.) EY's sales efforts were successful and Standard Register selected EY as an implementation consultant and paid EY \$11.6 million to install and implement PeopleSoft's financial modules. (Div. Ex. 428.)

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<sup>32</sup> PeopleSoft salespeople rated EY a four on a five-point scale on a sale to Standard Register. (Div. Ex. 319.)

Ms. Anderson learned at the user conference that an EY audit client, Arkansas Best Freight Co. (“ABF”), had not yet selected a software vendor. On September 9, 1999, Ms. Anderson gave Mr. Kavanagh, who succeeded Mr. Horne as PeopleSoft’s Global Alliance Manager for EY in July 1999, this information and requested that he supply her with a list of freight companies who have PeopleSoft modules. (Div. Ex. 210.) At the hearing, Ms. Anderson denied she was trying to help PeopleSoft make a sale and claimed EY was obtaining information for ABF at its request. (April 2, 2003, Tr. 221-22.)

On September 13, 1999, in an e-mail titled “Need Info,” Ms. Anderson stated, “We are trying to ‘sell’ PeopleSoft as the solution for [a potential client].” (Div. Ex. 365.) In the same e-mail, Ms. Anderson requested customer information and Mr. Kavanagh responded. (April 2, 2003, Tr. 257-58; Div. Ex. 365 at 035679.)

On January 4, 2000, Ms. Anderson requested PeopleSoft give EY the names of cruise companies that have PeopleSoft modules because “[w]e are heavily involved in the entertainment area (i.e. hospitality, gaming and cruise lines) and [the Hospitality Group] would like to have any info you have on that and what you are doing to help sell [PeopleSoft] as the package of choice for that segment.” (Div. Ex. 361.) Ms. Anderson testified that she made the request because EY clients wanted the information. (April 2, 2003, Tr. 252-54.)

## **Joint Marketing**

EY’s direct and indirect activities with PeopleSoft amounted to joint marketing in an effort to increase implementation sales. EY marketed its implementation services by emphasizing a close working relationship with PeopleSoft. On its Web site, EY stated that its commitment to PeopleSoft includes “joint development between E&Y and PeopleSoft in several areas, continuous feedback directly to PeopleSoft development and product strategists for functional enhancements, and even significant involvement in the testing of PeopleSoft’s latest releases.” (Div. Ex. 185.) EY presented Adventist Health Systems with a work solicitation document dated January 19 and 20, 1999, that shows the PeopleSoft logo and the words, “Implementation Partner,” describes EY/GEMS for Human Resources as a joint product with PeopleSoft, and lists EY as a PeopleSoft Global Implementation Provider and alliance member. (Div. Ex. 583 at 043378, 043399, 043402.) A work proposal that EY submitted to Federal Express sets out the “[s]trengths of EY according to PeopleSoft taken directly from [PeopleSoft’s] ‘1997 Global Alliance Program.’” (Div. Ex. 256 at 033467.) In a work proposal submitted to Primerica Financial Services, EY stated, “As a PeopleSoft Global Solutions Provider, we have been placed in a class above the rest based on our depth and breadth of knowledge in the PeopleSoft arena. PeopleSoft has positioned us in this role due to our functional and technical capabilities, as well as our proven ability to support large scale PeopleSoft implementations.” (Div. Ex. 225 at 032565.)

Sprint Communications Company (“Sprint”) was EY’s largest implementation client and a major client of PeopleSoft. Mr. Fridley informed PeopleSoft on May 17, 1999, that Sprint had asked him to facilitate a meeting with PeopleSoft’s senior management to discuss their difficulties and concerns regarding PeopleSoft. Mr. Fridley proposed a dinner meeting for executives of Sprint and PeopleSoft, which he and EY’s account partner and engagement

director would also attend. (Div. Ex. 315.) Mr. Fridley saw this as an opportunity to sell additional software, and a “win/win opportunity for Sprint, PeopleSoft, and E&Y.” (Id.)

On June 10, 1999, EY’s Alex Zmoira informed PeopleSoft that Sprint was interested in PeopleSoft’s Treasury module. Mr. Zmoira requested that PeopleSoft suggest a date when PeopleSoft could conduct a demonstration for Sprint. Also, EY’s project manager at Sprint would inform PeopleSoft’s account manager of the sales opportunity with Sprint. (Div. Ex. 281 at 34536.)

In June 1999, Mr. Fridley wrote to PeopleSoft:

At our last session of those E&Y Partners that routinely interact in service/working with PeopleSoft, we discussed the desirability of a regular interchange/checkpoint on how we are working together. . . . putting together a balanced scorecard that captures how we are doing together on the many dimensions that E&Y and PeopleSoft operate across. The idea we discussed was a quarterly meeting of 1 hour duration where we would review the status (and hopefully accomplishments) across the three dimensions in which we operate:

1. PeopleSoft as a full service customer of E&Y – where we provide audit, tax and consulting services to your company;
2. E&Y as a major customer of PeopleSoft (probably your largest customer in the Services industry by quite a margin); and
3. The serving of mutual customers of PeopleSoft and E&Y in the marketplace – how can we both grow our sales there – which is really important to you and me.

. . . Overall, I believe that we are working better together in the “field” and on several initiatives (i.e., Healthcare, Treasury Management, EPM, etc.). The information in the PeopleSoft closed business report seems to support that also.

(Div. Ex. 180.)

On July 22, 1999, EY’s project manager for Standard Register, James R. Mittenzwei, asked PeopleSoft to contact Standard Register on behalf of EY. “I would sure like to close this deal and make this a successful project for SRC, PeopleSoft and EY. . . . as soon as we are selected I would like to make the introductions between you and the Sr. VP’s at SRC in regards to Ecommerce and EPM.” (Div. Ex. 287 at 034601.) On July 26, 1999, Tim Schinke, PeopleSoft’s Vice President for the Midwest Region, sent Standard Register a letter that Mittenzwei had drafted endorsing EY.<sup>33</sup> (April 2, 2003, Tr. 57-60.)

Given the complexity, importance and value that will be achieved in your project, we continue to endorse Ernst & Young as your implementation Partner.

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<sup>33</sup> Mr. Mittenzwei later became a principal at EY. (April 2, 2003, Tr. 57.)

EY has been a highly successful global alliance implementation provider of PeopleSoft since the early 1990's. Their proven success in running large PeopleSoft projects, streamlining business processes, understanding our products and focusing on business value are strengths of EY as an implementation service provider for large scale projects.

(Div. Ex. 500B.)

In a November 21, 1999, letter, Ms. Anderson suggested to PeopleSoft integrating two EY services into PeopleSoft to get a dynamic combination.

I think it would be [a] great idea to draft a distinct letter to communicate EY's new direction . . . and what we are investing in . . . and how [PeopleSoft] can benefit and our clients can benefit. I'd like to target specifics and send [it] to right folks as well as put together a plan to really make it happen. I believe we can [despite] the current inquiry - (I'd like a letter both aimed at [PeopleSoft] executives as well as EY account/leaders as well.)

(Div. Ex. 355.)

EY submitted a request for proposal for implementation of PeopleSoft HRMS software on February 28, 2000, which stated that EY enjoyed a lengthy, close working relationship with PeopleSoft, including joint development in several areas "including redesigning their HRMS application." (Div. Ex. 513 at 039944.) "We have developed jointly with PeopleSoft, EY/GEMS, a global expatriate tax system integrated with PeopleSoft Payroll." (Id.) The request for proposal states that EY provided more resources to test PeopleSoft's version 7.5 release than the combination of other Big Five firms, and that it developed jointly with PeopleSoft, EY/GEMS, a global expatriate tax system integrated with PeopleSoft payroll. (Id.)

From at least 1994 through 1999, EY regularly sent representatives from the PeopleSoft Service Line, expatriate services, and other units to user conferences attended by over 10,000 people, and held to generate sales of PeopleSoft's products and services. (April 1, 2003, Tr. 28-29; Div. Ex. 511 at 039897.) PeopleSoft only invited its "certified PeopleSoft business partners" to have display booths featuring their products and sales representatives in what it called the "Products and Partners Fair." (Div. Ex. 495, Tab A at 038679, Tab B at 038736, Tab C at 038846, Tab D at 038975.) EY and some four or five hundred companies paid from \$5,000 to \$40,000 to have a booth at the user conference. (April 1, 2003, Tr. 28-29.) EY considered its participation in the conference to be a marketing effort, and it advised its attendees to promote EY in all activities, network with PeopleSoft personnel and other key strategic alliance partners, and interact with current or potential clients. (Div. Ex. 511.)

PeopleSoft enlarged the focus of the 1999 Users Conference and ran an Executive Symposium for prospective customers. The new event was to help PeopleSoft's implementation partners "close hot prospects." (Div. Ex. 205 at 032443.) Each PeopleSoft partner among the "Big Six" accounting firms could bring eight people with a minimum of four prospects. EY supplied four names for the prospect dinner. (Div. Ex. 205 at 032449-50.)

On December 12, 1999, after she was aware that EY was under investigation for independence violations, Ms. Anderson informed Mr. Kavanagh that EY “would DEFINITELY be interested” in working with PeopleSoft HR marketing to develop a white paper and presentation on key human relations issues for high-level business executives. (April 2, 2003, Tr. 243-46; Div. Ex. 360 at 035358) (emphasis in original.) Based on the Guidelines and advice from EY people working on PeopleSoft audits and the legal department, Ms. Anderson believed that EY could participate in joint marketing with PeopleSoft as long as others participated. (April 2, 2003, Tr. 245-46.) However, PeopleSoft’s inquiry about EY’s participation does not mention any other firm. (Div. Ex. 360.)

On February 11, 2000, Ms. Anderson informed others at EY that PeopleSoft had asked EY to work closely with PeopleSoft in the rollout of a new PeopleSoft Professional Services Automation offering, and questioning whether the situation posed opportunities for EY inasmuch as it had experience with a similar product. (Div. Ex. 398.) A related PeopleSoft press release identified EY as a satisfied PeopleSoft customer. Ms. Anderson claims EY’s audit and legal groups approved EY’s participation in the press release, which Ms. Anderson does not consider an endorsement of an audit client’s product. (April 2, 2003, Tr. 264-66.)

### **Confidential Information**

The evidence is that EY shared considerable proprietary, confidential business information with PeopleSoft so that PeopleSoft would reciprocate and work with EY to achieve sales. Specifically, EY provided Mr. Horne with a copy of Mr. Fridley’s PeopleSoft Business Plan Summary, dated December 1998, that described EY’s efforts to:

Continue to build strong “field” [PeopleSoft’s technical and salespeople] relationships with PeopleSoft.<sup>34</sup>

Develop and execute an account plan that focuses on PeopleSoft’s growth opportunities and which ones EY can tie into and achieve market dominance.

Identify and work with PeopleSoft on new solutions that are industry specific.

(Div. Ex. 179B at 032219-20, 486 at 038547.) Mr. Fridley intended to focus on health care, services industry, PeopleSoft Select, and Treasury Management Initiative. (April 1, 2003, Tr. 205.)

In December 1998, Mr. Horne of PeopleSoft was the only outsider to participate in a two-day EY brainstorming session that focused on enhancing and defining EY’s PeopleSoft Service Line’s business plan for 1999. (April 1, 2003, Tr. 177-78, 189; Div. Ex. 363 at 035498.) The meeting dealt with confidential material. (April 1, 2003, Tr. 191.) The meeting materials

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<sup>34</sup> Significant strengthening of PeopleSoft “field” relationships was a major EY achievement in fiscal year 1998. (April 1, 2003, Tr. 204; Div. Ex. 179B at 32218.)

contained the statement, “We really need to join fully with PeopleSoft because we are joined at the hip.” (Div. Ex. 363 at 035453.)

In 1999, EY sent PeopleSoft internal EY privileged and confidential sales reports for the EY’s PeopleSoft Service Line biweekly. The reports showed sales, the names of businesses that were active leads and pursuits, and information about EY’s employees. (April 1, 2003, Tr. 166-70, 172; Div. Ex. 338A.) Other internal confidential documents sent to PeopleSoft included a newsletter with information supplied by EY’s global representatives, and a list of EY’s global clients. (April 1, 2003, Tr. 171-72; Div. Exs. 338C, 338E.)

On January 1, 1999, Mr. Fridley directed others at EY:

[t]o get information on our mutual HRMS customers (PeopleSoft and EY) by industry segment as well as our target accounts; and make this information available to [PeopleSoft’s Global Alliance Manager and his boss] for internal marketing only. Stuart [Horne] and Bill [Parsons] for internal marketing only. Stuart and Bill - you will have to use the info very judiciously.

(Div. Ex. 227 at 32658.) Mr. Horne recognized that Mr. Fridley did not want other companies working with PeopleSoft to have the information. (March 31, 2003, Tr. 101.)

On May 25, 1999, Mr. Fridley gave notice to Howard Gwin at PeopleSoft that he would soon be requesting a meeting to discuss a number of “potential areas of synergy with E&Y and PeopleSoft.” (Div. Ex. 166.) In the same message, Mr. Fridley responded to a request Mr. Gwin made in October 1998, and transmitted to Mr. Gwin and Mr. Horne “a very confidential list of [EY’s] major global clients” that EY considered proprietary. (Id.) Mr. Fridley shared this highly sensitive information so that PeopleSoft could “use it as an early warning mechanism on when [PeopleSoft and EY] should align.” (Id.)

On June 9, 1999, Ms. Anderson requested that PeopleSoft give her “a list of all [its] Hospitality clients and which modules they have.” (Div. Ex. 321 at 035091.) Ms. Anderson claims she requested the information for an EY client, and that it was public information. (April 2, 2003, Tr. 211.) “This might help a client go with PeopleSoft solution[s] rather than do a packaged selection . . . I am trying to work that out.” (Div. Ex. 321 at 035091.)

EY furnished PeopleSoft with EY’s biweekly reports on sales, active customer leads, and employee utilization. (Div. Exs. 338A, 338B.) This material was marked “for internal use only,” and Mr. Fridley considered it information EY wanted to keep to itself. (April 1, 2003, Tr. 167; Div. Ex. 338C at 035170.)

EY and PeopleSoft met on December 1 and 2, 1999, to identify and line up EY salespeople with PeopleSoft’s salespeople in terms of products and industries. (April 2, 2003, Tr. 227-28; Div. Ex. 206B at 032452.) Ms. Anderson testified that the agenda item, “Align opportunities for EY via streams/industries” referred to updating the responsibilities of PeopleSoft employees. (April 2, 2003, Tr. 228-29; Div. Ex. 206B at 032452.) Ms. Anderson

claimed EY held similar meetings with all its vendors as it needed this information to plan the services it would offer and for training purposes.

I discount Dr. Hitt's testimony minimizing the significance of this sharing of information because there were few secrets in the software industry. The witness testimony and the markings on many of the documents indicate that they were considered confidential and proprietary.

### **Testimonials for PeopleSoft Products**

From April 1998 to August 1999, PeopleSoft highlighted EY as a satisfied PeopleSoft customer in a marketing program to sell software. (April 2, 2003, Tr. 130-33, 150-60, 169; Div. Exs. 258 at 033620, 300A.) PeopleSoft chose EY because it had company name recognition, and PeopleSoft's new services industry software was suited for EY's operations. (April 2, 2003, Tr. 132, 141-42.) At PeopleSoft's invitation, Mr. Richardson participated at a major PeopleSoft sales event attended by chief financial officers and chief information officers in March 1999, as a satisfied PeopleSoft customer. (April 2, 2003, Tr. 150-01; Div. Exs. 258 at 033620, 300B.) EY expected its presentation and distribution of material would assist its sales of its consultation services. (April 2, 2003, Tr. 7-9, 11, 19; Div. Ex. 199 at 032382.)

Also, in June 1999, Mr. Richardson appeared as a customer at a PeopleSoft interactive audio conference and described how EY successfully created for itself one of the largest PeopleSoft Financials-based Service Implementations in the world. (April 2, 2003, Tr. 162-63; Div. Exs. 300A, 320 at 35080, 35082.) The PeopleSoft User Conference featured a similar session with an EY representative.<sup>35</sup> (April 2, 2003, Tr. 149.) In each instance, PeopleSoft and EY coordinated their presentations.

Based on her endeavors with Mr. Richardson, Ms. Jeffries assumed there were no auditor independence problems if PeopleSoft treated EY just like it treated any customer making a testimonial on its behalf. (April 2, 2003, Tr. 165.) Ms. Jeffries took Mr. Richardson's recommendation that EY be PeopleSoft's preferred partner for service industries to mean that Mr. Richardson wanted PeopleSoft to recommend that EY implement the software. (April 2, 2003, Tr. 165-66.) Ms. Jeffries considered that Mr. Richardson simply paid lip service to the restrictions imposed by the audit relationship. (April 2, 2003, Tr. 184.)

### **Health Care Initiative**

EY and PeopleSoft saw the health care industry as a lucrative market for their products and services and they embarked on a Health Care Initiative to make sales.<sup>36</sup> Major health care providers, mainly hospitals, are large users of computer software programs. Beginning in

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<sup>35</sup> Pursuant to their agreement, Pamela Jeffries, PeopleSoft's manager of marketing communications for service industries, communicated sales leads developed at the audio conference to Mr. Richardson on July 1, 1999. (April 2, 2003, Tr. 172-73; Div. Ex. 283.)

<sup>36</sup> PeopleSoft considered EY to be the strongest health care implementer, and it wanted to convince EY that PeopleSoft software was a good solution for EY clients. (April 7, 2003, Tr. 15-16.)



November 1998, EY began meeting with PeopleSoft's senior management on what could be done to improve each company's share of the health care portion of the services industry market. (Div. Ex. 199 at 032385.) At EY's request, PeopleSoft arranged for EY consultants to meet with PeopleSoft sales representatives in late 1998. (March 31, 2003, Tr. 59; Div. Ex. 313.) In one sales initiative, EY met with PeopleSoft health care salespeople and made specific assignments in terms of "geography and accounts to directly target/prioritize opportunities." (Div. Ex. 199 at 032385.)

In 1998 and 1999, PeopleSoft's health care unit alliance manager organized meetings of PeopleSoft's salespeople trying to sell software to an account with salespeople from EY or another service firm partner who interacted with that account. (April 7, 2003, Tr. 6-12.) The goal was to share information and to establish a working relationship that would result in sales for PeopleSoft and EY. (April 7, 2003, Tr. 12.) PeopleSoft also arranged many meetings in regions, states, and cities where its sales force and product experts would meet with EY partners to share information about accounts. (April 7, 2003, Tr. 12-14.)

PeopleSoft prepared a "1999 Master Account Plan PeopleSoft, Inc., Ernst & Young LLP," which described the mission of its relationship with EY as growing the list of joint clients by, among other things, developing strong local relationships between the two firms. (Div. Ex. 165 at 032029-30). The plan refers to the "E&Y PeopleSoft practice," to EY as a "Software partner," and that "because of [its audit] relationship E&Y is committed to helping PeopleSoft grow and become a successful company." (Div. Ex. 165 at 032030.) The reference to "grow" is to increase PeopleSoft sales. (March 31, 2003, Tr. 130-31.) Under "Strategic Market Initiatives – Health Care," the plan describes an effort headed by the Health Service Line leaders at both PeopleSoft and EY to "educate E&Y Target Account leaders on the benefits that PeopleSoft products can bring to their clients." (Div. Ex. 165 at 032034.) Under "Other Markets - Secondary Initiatives," PeopleSoft envisioned working with EY "opportunisticly in the larger market retail sector," and setting up a planning meeting with EY Revenue team leaders and others "to discuss opportunities in insurance and banking." (Div. Ex. 165 at 032036.)

To assist PeopleSoft meet its revenue targets for implementations, Ms. Duginski, notified thirteen PeopleSoft salespeople on January 18, 1999, that EY had identified contact people for PeopleSoft to work with to help EY close business deals. (Div. Ex. 173, 190 at 032342; April 7, 2003, Tr. 54-58.) Ms. Duginski wrote:

**E and Y must help PeopleSoft close 7 to 10 healthcare deals in the next 45 days** in order for them to reach their numbers. They know they have more success in that endeavor when [they] help us in the sales cycle. (According to the closed business report from the last 12 months, all six deals in which they were involved in the sales cycle resulted in their winning the implementation.) **They realize they will have more success in their sales cycle if they help us with ours.** Let them help in your sales cycle.

(Div. Ex. 173) (emphasis in original.) These EY contacts would identify EY's experience in the account, devise a joint strategy for EY and PeopleSoft "to win," and when necessary, sell the partner responsible for the account why PeopleSoft is the right solution. (Id.) Mr. Horne

believed Ms. Duginski's message indicated that "cooperation in the sales cycle is mutually beneficial." (March 31, 2003, Tr. 105.)

In January 1999, a PeopleSoft salesperson in Texas informed an EY partner of the health care accounts in Texas where he was focusing his sales efforts. (April 7, 2003, Tr. 50-51; Div. Ex. 297S.) In late January 1999, EY made a joint sales presentation with PeopleSoft to Adventist Hospital. PeopleSoft, the vendor, was present to support EY's two-day presentation. (March 31, 2003, Tr. 210-12.) Mr. Flury believed that PeopleSoft won the SI contract, which would have been for two to eight times the \$1.5 million software cost. (March 31, 2003, Tr. 213-14.)

On May 27, 1999, Mr. Horne asked EY for the names of EY personnel with contacts at eight health care providers that PeopleSoft intended to target. PeopleSoft sought the information to see "if we can leverage the relationships the large [systems implementers] have with these [Health Plan providers]." (March 31, 2003, Tr. 138-39; Div. Ex. 316.)

On July 21, 1999, Mr. Fridley forwarded to several people at EY an e-mail from Zan Calhoun, an EY partner in health care, suggesting, among other things, joint sales visits by EY and that EY "swarm the accounts with PeopleSoft, under the assumption that there is plenty of money there for all of us and if we help them, they'll help us. I think we can do that without any audit relationship issues." (April 2, 2003, Tr. 214-18; Div. Ex. 450A.) Mr. Fridley forwarded Mr. Calhoun's ideas, noting that some of Mr. Calhoun's ideas for the 2000 business plan were "very good." Mr. Fridley did not state that the independence rules prohibited joint sales by an auditor and its client. (April 2, 2003, Tr. 216-17.) According to Ms. Anderson, EY did not follow through on Mr. Calhoun's recommendations. (April 2, 2003, Tr. 216-18.)

### **PeopleSoft Express Initiative**

EY's PeopleSoft 1999 Business Plan included a strategy to enable EY to become dominant in PeopleSoft Express. (Div. Ex. 199 at 032370, 032375, 032386-87.) An undated EY document titled, "PeopleSoft Select/Express Information Guide," refers to two meetings that discussed an operating agreement for "Partnering" with PeopleSoft and an agreement in principle to work together for PeopleSoft Express implementations. (Div. Ex. 231 at 032687, 032706.) PeopleSoft Express involved a bundling of software to sell to small companies where the software installation did not require customization. (April 2, 2003, Tr. 26.) According to Mr. Fridley, PeopleSoft was making sales based on leads furnished by EY, and then PeopleSoft was doing the implementation. The "operating agreement really referred to . . . rules for the road in terms of the exchanging leads. Because if all [EY] were doing was giving them leads and they were selling, then that wasn't going to last very long." (April 2, 2003, Tr. 29.) Mr. Fridley testified that EY and PeopleSoft were to share leads and then make independent selling efforts; however, the document specifies "an agreement with PeopleSoft Inc.'s national leadership to go to market together" and aggressive market efforts "independently" and "[w]ith PeopleSoft." (April 2, 2003, Tr. 36; Div. Ex. 231 at 032708-9.) In March 1999, EY and PeopleSoft met to evaluate EY's "PeopleSoft Express" project. (March 31, 2003, Tr. 121-29; Div. Ex. 176 at 032166.) PeopleSoft used the term "express" "to describe [PeopleSoft's] rapid implementation methodology that leverages 'Partners' as integrators." (Div. Ex. 176 at 032177.) The materials

prepared for the meeting indicate that with respect to the procedure for agreement on EY's changes to the Statement of Services ("SOS"):

PeopleSoft Inc. (Joe Mangano) will want to review all changes to an SOS that will be used for a client that PeopleSoft has discussed implementation scope and pricing with, and subsequently forwarded to E&Y. This is to ensure that we are not sending mixed messages to the potential clients.

PeopleSoft Inc. will also consider incorporating changes that E&Y suggests to assist in the efforts of going to market with similar offerings.

No review is necessary for an SOS that E&Y will be using for clients that they are contracting with independent of PeopleSoft Inc.

(Div. Ex. 176 at 32190.) Mr. Fridley claimed that to the best of his knowledge no leads were shared because new management at PeopleSoft abandoned the effort. (April 2, 2003, Tr. 35.) However, the fact that EY was dissatisfied with the arrangement indicates that some activities had occurred. Also, if nothing had happened, there would be no need for an evaluation session.

### **Services Industry Initiative/BERT**

The services industry consists of companies that offer services instead of products, such as law firms, accounting firms, software firms, and manpower type agencies. (April 2, 2003, Tr. 6-7.) EY considered itself a services company. (March 31, 2003, Tr. 155.) During the relevant period, EY wanted to package the knowledge it had gained implementing PeopleSoft's products in-house and offer those services to customers it had in the services industry. (*Id.*) EY called its internal system BERT. EY and PeopleSoft engaged in serious discussions and planning, but BERT never went into effect.

In 1999, EY embarked on a Services Industry Initiative, which included elevating "the PeopleSoft/E&Y relationship to premier status," aligning "with PeopleSoft's sales force in the field to drive sales and utilize best practices to dominate/close service industry opportunities," and working with PeopleSoft on product enhancement. (Div. Ex. 228 at 032662.) Mr. Fridley asked to meet with Mr. Gwin at PeopleSoft in July 1999, "for a quarterly update and to review EY's plans to invest in the Services Industry with PeopleSoft." (Div. Ex. 328.) Mark Richardson at EY sent PeopleSoft a discussion draft of a "Business Services Industry Initiative, June 1999." (Div. Ex. 258.) The twenty-one-page slide presentation was the subject of a phone call with PeopleSoft's Director of Product Development. (March 31, 2003, Tr. 156; Div. Ex. 258.) The presentation noted that: (1) "EY has significant intellectual capital and many experienced resources focused on the services industry that can help PeopleSoft enhance its products and increase sales;" (2) EY can help accelerate PeopleSoft's sales; (3) PeopleSoft and EY should work together on a Business Services Industry Initiative; (4) PeopleSoft and EY can generate significant new revenue from growth in the services industry and access to new accounts; (5) working together will lead to cross-selling other EY services and PeopleSoft software; and (6) PeopleSoft and EY should work together to build and deliver a PeopleSoft and EY Services Industry solution. (Div. Ex. 258 at 033616-17, 033623, 033625.)

In April 1999, Mr. Fridley passed on to others at EY, including Mr. Frick, notes from a meeting with PeopleSoft that considered what EY would like to see develop with PeopleSoft “as partnering organizations” around opportunities for both companies in the Services Industry. (Div. Ex. 236.) Mr. Richardson believed the following actions were desirable in the “PeopleSoft/EY marketing and sales partnership:”

- a. E&Y to be the preferred partner for Services Industries
- b. An ongoing dialogue regarding products, tools, etc.
- c. PeopleSoft to deliver presentations regarding [PeopleSoft] solutions within the E&Y organization
- d. PeopleSoft to assist with E&Y presentations

(Div. Ex. 236 at 032749.) Mr. Richardson committed EY to be the featured customer at a PeopleSoft “Service Supply Chain” audio conference. (Id.) Mr. Frick does not consider that meetings of PeopleSoft and EY sales forces to identify common realistic sales prospects would raise concerns about joint sales and independence problems. (March 25, 2003, Tr. 109.)

### **Treasury Initiative**

PeopleSoft had an initiative to interest software implementers in its Treasury Management Module. Mr. Fridley believed that this PeopleSoft initiative presented an opportunity for EY. In November 1998, Mr. Fridley requested and received from PeopleSoft a confidential list of companies that had purchased PeopleSoft’s Treasury Management module. (Div. Ex. 171.) Mr. Fridley intended to use the confidential customer list to “get started on a target list of prospects for EY.” (Id. at 032121.) In December 1998, Mr. Fridley directed the EY consultants that:

We need to smartly go to each of the industry segments where we have gaps and have someone from the PeopleSoft service line help us grow that particular market. . . . we need to look at treasury and decide whether or not this is an area where we would like to dominate so we can put forth plans and really get there. Mark Richards will be doing some co-development with PeopleSoft.

(Div. Ex. 364 at 035533.)

On March 3-4, 1999, Mr. Fridley, Mr. Frick, and Phillippe Paradis attended a meeting of representatives from the EY practice groups that had PeopleSoft as a client to consider the EY PeopleSoft 1999 Business Plan.<sup>37</sup> (Div. Ex. 199 at 032369, 032408.) The 1999 Business Plan projected refocusing the PeopleSoft Service Line on, among other things, achieving dominance in implementing PeopleSoft’s Treasury Management Module. (Div. Ex. 199 at 032375.) The Treasury Management Module proposed having EY “[w]ork with PeopleSoft’s senior

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<sup>37</sup> Mr. Paradis worked with Mr. Frick on the PeopleSoft audits. Mr. Paradis became an EY partner in 1998 or 1999. (March 25, 2003, Tr. 18.)

management to drive rapid sales (probably through SWAT force and/or ‘one to many’ center selling approach).” (Div. Ex. 199 at 032380.)

In approximately May 1999, EY named a senior partner to EY’s effort to make sure EY was doing all the right things and PeopleSoft Treasury Management Module was successful. EY and PeopleSoft representatives met in June 1999. (Div. Ex. 286 at 034588-89.) The goal was “to develop joint [EY-PeopleSoft] treasury strategy and plans.” (*Id.*) EY was “looking forward to continuing a successful E&Y-PeopleSoft relationship in the [PeopleSoft Treasury] arena.” (*Id.*) EY’s Mr. Zmoira urged that the “to do” list that came out of the June meeting on how EY and PeopleSoft planned to work together on sales be treated with extreme confidentiality. (Div. Ex. 172 at 032129.)

There is no evidence that EY carried through on its proposed joint marketing program with PeopleSoft. EY argues that the testimony of Mr. Horne is that the Treasury Management Initiative did not occur. (EY Brief at 90-91.)

#### **IV. CONCLUSIONS OF LAW**

##### **Applicable Legal Standards**

The Division alleges that EY violated Rule 2-02 of Commission Regulation S-X, caused PeopleSoft to violate Sections 7(a) and 10(a) of the Securities Act and Sections 13(a) and 14(a) of the Exchange Act and Rules 13a-1 and 14a-3, and violated Section 4C of the Exchange Act and Rule 102(e) of the Commission’s Rules of Practice.

Various provisions of the federal securities statutes mandate that financial statements incorporated in Commission filings be certified by an independent public or certified accountant. Sections 7(a) and 10(a) of the Securities Act and Items 25, 26, and 27 of Schedule A to the Securities Act; Sections 12(b), 13(a), 14(a), and 17(e) of the Exchange Act; Section 30(i) of the Investment Company Act of 1940; and Section 203(c) of the Investment Advisers Act of 1940. The Commission has used its authority to define “accounting, technical, and trade terms” under Section 19(a) of the Securities Act and Section 3(b) of the Exchange Act to define the term “independent.”

Congress granted the independent auditor an important public trust in the framework it enacted for the federal regulation of securities.<sup>38</sup> Auditors have been characterized as “gatekeepers” to the public securities markets that are crucial for capital formation.

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<sup>38</sup> See Subcomm. on Oversight and Investigations of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess., Federal Regulation and Regulatory Reform 35 (Subcomm. Print 1976) (Moss Report); “Relationships Between Registrants and Independent Accountants,” Accounting Series Release (“ASR”) No. 296 (Aug. 20, 1981); Codification of Accounting Standards and Procedures, Statement on Auditing Standards No. 1, § 220.03 (American Inst. of Certified Pub. Accountants 1999).

The independent public accountant performing this special function owes ultimate allegiance to the corporation's creditors and stockholders, as well as to the investing public. This "public watchdog" function demands that the accountant maintain total independence from the client at all times and requires complete fidelity to the public trust.

As we have stated, the federal securities laws make "independent auditors the 'gatekeepers' to the public securities markets. This statutory framework gives auditors both a valuable economic franchise and an important public trust. Within this statutory framework, the independence requirement is vital to our securities markets."

KPMG Peat Marwick LLP, 74 SEC Docket 384, 406 & n.54 (Jan. 19, 2001) (citation omitted), reconsideration denied, 74 SEC Docket 1351 (Mar. 8, 2001), petition for review denied, 289 F.3d 109 (D.C. Cir. 2002).

Throughout its history, the Commission has stressed that auditor independence is essential to the notion that an auditor's opinion on financial statements provides investors with critical assurance that the financial statements have been subject to a rigorous examination by an impartial and skilled professional.

The auditor is the only professional that a company must engage before making a public offering of securities and the only professional charged with the duty to act and report independently from management. Because it is the issuer's responsibility to file independently audited financial statements, if the auditor is not independent, the issuer's filings are deficient under the securities laws.

Proposed Revision of Commission's Auditor Independence Requirements, 65 Fed. Reg. 43,148, 43,150 (July 12, 2000) in evidence as EY Ex. 1309. The courts have supported the Commission's consistent public assertion that auditor independence is crucial to the statutory scheme which aims to protect the vitality of the capital markets. United States v. Arthur Young & Co., 465 U.S. 805, 817-18 (1984); Cornucopia Gold Mines, 1 S.E.C. 364, 366-67 (1936).

EY acted through its partners, officers, and employees and their actions are imputed to the firm. Mallis v. Bankers Trust Co., 717 F.2d 683, 689 n.9 (2d Cir. 1983) ("It is a basic tenant of the law of agency that the knowledge of an agent, or for that matter a partner or joint venturer, is imputed to the principal."); see also C.E. Carlson, Inc. 859 F.2d 1429, 1435 (10th Cir. 1988); A.J. White & Co., 556 F.2d 619, 624 (1st Cir. 1977); SEC v. Manor Nursing Center Inc., 458 F.2d 1082, 1096-97 (2d Cir. 1972).

### **Rule 2-02(b) of Commission Regulation S-X and GAAS**

Rules 2-01 and 2-02 of Regulation S-X are the Commission's two key rules on auditor independence. 17 C.F.R. §§ 210.2-01, .2-02. Rule 2-01(b) specifies that an accountant must be independent to be recognized by the Commission. In this proceeding, the Division seeks to

apply Rule 2-01 before it was amended in 2000.<sup>39</sup> (Div. Initial Brief at 8 n.2 (citing KPMG, 74 SEC Docket at 407 n.56).)

Rule 2-01 stated:

(b) The Commission will not recognize any certified public accountant or public accountant as independent who is not in fact independent. For example, an accountant will be considered not independent with respect to any person . . . (1) in which, during the period of his professional engagement to examine the financial statements being reported on or at the date of his report, he [sic], his firm, or a member of his firm had, or was committed to acquire, any direct financial interest or any material indirect financial interest . . .

(c) In determining whether an accountant may in fact be not independent with respect to a particular person, the Commission will give appropriate consideration to all relevant circumstances, including evidence bearing on all relationships between the accountant and that person or any affiliate thereof, and will not confine itself to the relationship existing in connection with the filing of reports with the Commission.<sup>40</sup>

17 C.F.R. § 210.2-01(b), (c) (Apr. 1, 2000). In circumstances where the relationship at issue is not otherwise delineated, the basic test for auditor independence that has emerged from Commission pronouncements is:

[W]hether a reasonable investor, knowing all relevant facts and circumstances, would perceive an auditor as having neither mutual nor conflicting interests with its audit client and as exercising objective and impartial judgment on all issues brought to the auditor's attention.

KPMG, 74 SEC Docket at 411 n.74 (Jan. 19, 2001) (citing FRR 50, 7 Fed. Sec. L. Rep. (CCH) ¶ 72,450 at 62,307-08, and Office of the Chief Accountant, Securities and Exchange Commission, Staff Report on Auditor Independence, 2 (1994)).

Independence in fact refers to a state of mind, a subjective condition not easily demonstrated. The Commission has held that independence in fact and appearance are equally important under the securities laws because audits must not only produce more reliable financial information, but investors must believe that they do, so that auditors must appear to be free of biases and prejudices that may impair their objectivity. KPMG, 74 SEC Docket at 409-10. For this reason, a showing of the auditor's mental state and the fact that the audit was properly performed do not establish that the auditor was independent. Id. at 415-16.

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<sup>39</sup> All references are to Rule 2-01 before it was amended in 2000.

<sup>40</sup> The preliminary note to the current Rule 2-01 states that the Rule "is designed to ensure that auditors are qualified and independent of their audit clients both in fact and in appearance." It seems reasonable that the purpose was the same prior to 2000.

The Commission has applied an appearance of independence standard since the enactment of Rule 2-01(b). KPMG, 74 SEC Docket at 407 n.58 (citing 2 John L. Carey, The Rise of the Accounting Profession to Responsibility and Authority: 1937-1969, 176-77, 180 (AICPA 1970) (“Thus, as commentators have recognized, this Commission has, from its beginning, refused to accept ‘certificates’ from auditors whose relations with clients would appear to the public to create conflicts of interest.”)); see also Codification of Accounting Standards and Procedures, Code of Professional Conduct No. 2, ET § 55.01 (American Inst. of Certified Pub. Accountants 1999) (“Independence precludes relationships that may appear to impair a member’s objectivity in rendering attestation services.”).

Rule 2-02(b)(1) of Regulation S-X requires that the accountant’s report state whether the audit was made in accordance with GAAS. The American Institute of Certified Public Accountants (“AICPA”), the professional organization representing accountants, issues pronouncements on GAAS in Statements on Auditing Standards issued by the AICPA’s senior technical body, the Auditing Standards Board. The AICPA has stated: “[i]ndependent auditors should not only be independent in fact; they should avoid situations that may lead outsiders to doubt their independence.” Codification of Accounting Standards and Procedures, Statement of Auditing Standards No. 1, § 220.03 (American Inst. of Certified Public Accountants 1999). Financial statements filed with the Commission must satisfy the Commission’s requirements where those rules are stricter than AICPA standards. KPMG, 74 SEC Docket at 409 & n.66.

### **Codification of Financial Reporting Policies - Section 602.02.g**

The Commission’s Codification of Financial Reporting Policies (“Codification”), Section 600, Matters Relating to Independent Accountants, is an authoritative discussion of auditor independence and contains the Commission’s responses to various scenarios on the subject. Codification, 7 Fed. Sec. L. Rep. (CCH) ¶ 73,251 et seq. The accounting industry has long relied on the Codification for guidance. Section 602.02.g of the Codification discusses examples of business relationships between an auditor and its audit clients that impact the auditor’s independence.<sup>41</sup>

Section 602.02.g of the Codification specifies that:

Direct and material indirect business relationships, other than as a consumer in the normal course of business, with a client . . . will adversely affect the accountant’s independence with respect to that client. Such a mutuality or identity of interests with the client would cause the accountant to lose the appearance of objectivity and impartiality in the performance of his audit because the advancement of his interest would, to some extent, be dependent upon the client. In addition to the relationships specifically prohibited by Rule 2-01(b), joint business ventures, limited partnership agreements, investments in supplier or customer companies, leasing interests, (except for immaterial landlord-tenant relationships) and sales by the accountant of items other than professional services are examples of other connections which are also included within this classification.

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<sup>41</sup> Section 602.02.g on business relationships has been renumbered as Section 602.02.e.



## **Commission's 1989 Response to Petition of Several Accounting Firms**

The parties both rely on a February 14, 1989, Commission response to a petition filed by Arthur Andersen & Co., Peat Marwick Main & Co., and Price Waterhouse to modify Section 602.02.g of the Codification to incorporate a materiality standard when evaluating auditor independence in a prime or subcontract relationship (or similar cooperative service arrangement) ("Commission's 1989 Response"). Arthur Andersen & Co., SEC No-Action Letter (Feb. 14, 1989), *available at* <http://www.sec.gov/info/accountants/noaction/aaartan1.htm>, in the record as Div. Ex. 129. In denying the petition, the Commission stated that:

The Commission has recognized that certain situations, including those in which accountants and their audit clients have joined together in a profit-seeking venture, create a unity of interest between the accountant and client. In such cases, both the revenue accruing to each party in the prime/subcontractor relationship and the existence of the relationship itself create a situation in which to some degree the auditor's interest is wedded to that of its client. That interdependence impairs the auditor's independence, irrespective of whether the audit was in fact performed in an objective, critical fashion. Where such a unity of interests exists, there is an appearance that the auditor has lost the objectivity and skepticism necessary to take a critical second look at management's representations in the financial statements. The consequence is a loss of confidence in the integrity of the financial statements. Application of the type of materiality standard proposed in the petition would fail to protect adequately against the loss of independence and the appearance of auditor partiality that result from this type of relationship.

. . . In addition, the Commission would not raise an independence question if the party receiving the combined services contracted separately with the auditor and the audit client for their respective portions of the service engagement, thereby separating the accountant's liability and contractual obligations from those of its audit client (unless the arrangement is considered to be a material indirect business relationship).

. . . In summary, the closeness and unity of interest inherent in joint business ventures . . . between an auditor and its audit client, rather than just the amount of revenues derived from such a relationship, creates a mutuality of interest between auditor and client and may cause financial statement users to question the auditor's objectivity.

Id.

## **EY's Broad Legal Challenges**

EY argues that there is no legal or factual basis for a finding that EY violated any statute or Commission rule or for the imposition of any sanctions against EY. Two of EY's legal arguments are that: (1) the Commission cannot sanction EY under Section 4C or Rule 102(e) for

any conduct that occurred prior to May 20, 1997, five years prior to issuance of the OIP in an earlier proceeding;<sup>42</sup> and (2) it would violate due process and fundamental fairness to sanction EY in view of its “good-faith attempts to comply with vague, open-ended rules that defy interpretation.” EY cites Section 602.02.g of the Codification, the Commission’s 1989 Response, two records of oral independence advice given by the Office of the Chief Accountant, and materials on the Commission’s Web site titled “Independence Reference Materials.” (EY Brief at 96-101, 111-23.)

The Division argues that Johnson does not apply to any of the remedies it recommends. It notes that in a consent filed in connection with registration statements that PeopleSoft filed on January 31, 1997, EY affirmed that it conducted independent audits in 1994, 1995, and 1996, and that audit engagements continue until they are terminated. (Div. Reply Brief at 20 n.14.) It notes further that there is not one case that supports EY’s position on disgorgement. (Id. at 21.) The Division considers Johnson inapplicable because in that case the court: (1) applied the limitations of 28 U.S.C. § 2462 to a proceeding brought under Section 15(b) of the Exchange Act, while this proceeding involves Rule 102(e) of the Commission’s Rules of Practice and Section 4C of the Exchange Act; (2) found no showing of a current need for relief while here the recommended sanctions are remedial measures needed because of the risk to the public; and (3) stated that 28 U.S.C. § 2462 does not apply to disgorgement or restitution. (Id. at 23.)

### **Ruling – Statute of Limitations**

EY’s interpretation of the holding in Johnson has no impact on this proceeding because EY’s conduct with PeopleSoft in connection with EY/GEMS for PeopleSoft and in connection with implementing PeopleSoft software continued well after May 20, 1997. The Licensing Agreement between EY and PeopleSoft was effective on October 1, 1994, but EY granted its last license for EY/GEMS for PeopleSoft under its Licensing Agreement with PeopleSoft in September/October 1999. EY Consulting continued activities with PeopleSoft in connection with implementing PeopleSoft software until EY sold its Consulting practice to Cap Gemini on or about May 25, 2000.

### **Ruling - Vagueness**

I reject EY’s defense that the Commission’s rules on auditor independence are so vague as to defy interpretation, and that EY made a good faith attempt to comply with them. Rules 2-01 and 2-02 of Regulation S-X and Section 602.02.g of the Codification are clear and unambiguous. EY understood the independence rules in 1995, because it agreed to abide by them. On March 13, 1995, the United States District Court for the Northern District of Texas

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<sup>42</sup> The parties entered into a tolling agreement, which covered the period between the dismissal of an earlier OIP issued May 20, 2002, and this one. (EY Brief at 96 n.34.) Johnson v. SEC, 87 F.3d 484 (D.C. Cir. 1996), held that the Commission could not impose a censure and six-month suspension because 28 U.S.C. § 2462, which imposed a five-year statute of limitations on “an action, suit, or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise,” was applicable in a Commission administrative proceeding.

entered a Final Order that contained the terms of a settlement where EY agreed with respect to its future activities to:

comply with standards and guidelines issued by the Commission and the accounting profession regarding the independence of public accountants that audit the financial statements of any issuer whose securities are registered with the Commission pursuant to Section 12 of the [Exchange Act] relating to loans, leases, and other business relationships with audit clients as specified in the Codification of Financial Reporting Policies Section 602.02.g.

SEC v. Ernst & Young, Civil Action No. 3-91-2267-X (N.D. Tx. 1995) (cited in the record as Div. Ex. 246). Based on the settlement, it seems reasonable to assume that EY understood the Commission's rules on auditor independence between 1995 and 2000.

EY's claim does not meet the established standard for showing that it did not have fair notice of what was prohibited by the Commission's independence rules. "Due process requires only that laws give a 'person of ordinary intelligence a reasonable opportunity to know what is prohibited.'" Michael J. Marrie, 80 SEC Docket 2694, 2720-21 (July 29, 2003) (citing Grayned v. City of Rockford, 408 U.S. 104, 108 (1972)). The Division has met the general requirement that a person must have received reasonable notice of what the government regulation required of the regulated public. Gen. Elec. V. EPA, 53 F.3d 1324, 1328-34 (D.C. Cir. 1995); Satellite Broad. Co. v. FCC, 824 F.2d 1, 3-4 (D.C. Cir. 1987); see also KPMG, LLP v. SEC, 289 F.3d 109 (D.C. Cir. 2002); United States v. Chrysler Corp., 158 F.3d 1350, 1354-57 (D.C. Cir. 1998); Upton v. SEC, 75 F.3d 92 (2d Cir. 1996); Timpinaro v. SEC, 2 F.3d 453 (D.C. Cir. 1993); Gates & Fox v. OSHRC, 790 F.2d 154 (D.C. Cir. 1986).

The Commission has stated that:

[d]isciplinary rules, like Rule 102(e), long have withstood vagueness challenges because professionals are deemed to know the standards that govern their conduct. The standards we enforce in this matter, basic concepts of GAAS such as the duties to exercise due care, to evaluate whether audit conclusions are supported by sufficient competent evidential matter, and to bring to the work an appropriate level of professional skepticism, are standards to which all accountant must adhere and which any accountant can be expected to understand.

Michael J. Marrie, 80 SEC Docket 2694, 2721 (July 29, 2003) (citing United States v. Hearst, 638 F.2d 1190, 1197 (9th Cir. 1980), cert. denied, 451 U.S. 938 (1981) and Crimmins v. American Stock Exchange, Inc., 368 F. Supp. 270, 277 (S.D.N.Y. 1973), aff'd, 503 F.2d 560 (2d Cir. 1974)).

## **Did EY/GEMS for PeopleSoft Violate the Independence Rules?**

### **Direct or Material Indirect Business Relationship**

Section 602.02.g of the Codification prohibits a direct and material indirect business relationship between an auditor and a client, unless the auditor is a consumer in the normal course of business. I will consider first whether EY and PeopleSoft had a direct or material indirect business relationship and, if that is true, whether EY was a consumer in the normal course of business.

The Division believes that the evidence establishes that EY and PeopleSoft engaged in a joint venture to create EY/GEMS for PeopleSoft and that EY and PeopleSoft openly promoted the product and touted their joint relationship with respect to it. (Div. Brief at 17-21.) The Division cites the expert testimony of Dr. Carmichael and Walter Rush, III in support of its position.<sup>43</sup> Dr. Carmichael views the Licensing Agreement as a direct business relationship, and that the joint involvement of EY and PeopleSoft in revenue generating activities was known to potential users of PeopleSoft financial statements by, among other things, EY's press release announcing the Licensing Agreement and other press reports. (Div. Exs. 242, 741 at 10-12.) Dr. Carmichael concluded that "[t]he joint business activity of development and marketing of EY/GEMS for PeopleSoft impaired EY's audit independence, and as a result, EY's audits of PeopleSoft's financial statements were not made in accordance with GAAS." (Div. Ex. 741 at 10.)

Mr. Rush believes that the Licensing Agreement violated the independence rules because it: (1) constituted a direct business relationship between EY and PeopleSoft; (2) created a mutuality of interest; (3) created a close identity in fact and appearance; (4) had important elements of partnering; and (5) did not involve a consumer in the normal course of business. (Div. Ex. 748 at 7-14.)

EY strenuously denies that EY/GEMS for PeopleSoft was a joint product. (EY Brief at 11-27.) EY contends that it developed and marketed EY/GEMS for PeopleSoft, and provided technical support. EY contends that it was allowed to use "a PeopleSoft development tool" to modify its existing GEMS product under Section 602.02.g of the Codification, which allows an

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<sup>43</sup> When he testified, Dr. Carmichael was the Director of the Center for Integrity in Financial Reporting at Baruch College, City University of New York, where he was the Wollman Distinguished Professor of Accountancy. Dr. Carmichael has a PhD in Accountancy, and is a CPA and a Certified Fraud Examiner. He is the author and co-author of numerous textbooks and scholarly articles. (Div. Ex. 741, Ex. 1.) Dr. Carmichael is now the Chief Auditor and Director of Professional Standards at the Public Company Accounting Oversight Board.

Mr. Rush has been a CPA for thirty-five years and is presently licensed in California and Colorado. Mr. Rush was a senior staff member of the Commission for two years and a partner with Coopers & Lybrand, the predecessor of PricewaterhouseCoopers for twenty years. Mr. Rush was the Northwest Regional Director of Accounting, Auditing, and SEC Reporting at Coopers & Lybrand. (Div. Ex. 748.)